No. 11,322.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

United States of America,

Appellant,

vs.

Homecrest Tract, Bank of America National Trust and Savings Association, Trustee,

Appellee.

BRIEF FOR APPELLEE

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Jurisdiction.

Appellee concurs in the statement of jurisdiction made by Appellant. (Appellant's Br. pp. 1 and 2.)

Statement.

This action was commenced in the District Court with the filing of a complaint for the recovery of income, excess profits, defense and capital stock taxes paid by Appellee to Appellant. [R. 2.] The total amount of said taxes is $5,474.97, together with interest thereon from the respective dates of payment. [R. 23-24.]

The complaint contains seven causes of action, each of which is bottomed on the same set of facts, except as to the year and kind and amount of tax involved. [R. 2-23.]

This action was submitted to the court below on a written stipulation of facts [R. 95-109], to which were attached Exhibits "A" to "K" [R. 109-155], and on oral testimony. [R. 156-171.] The stipulation of facts, together with the Exhibits "A" to "K," was incorporated in the court's findings of fact and each fact so stipulated was by reference found as facts. [R. 172.] The facts so found are as follows:

On or about the 28th day of January, 1926, at Bakersfield, California, fourteen persons as trustors entered into a trust agreement with the Security Trust Company, as trustee, and conveyed to the trustee certain real property, and on June 23, 1937, a supplemental agreement was executed by eleven of the original trustors and one new trustor, wherein it was agreed that the Bank of America National Trust and Savings Association was the successor of the said Security Trust Company and had succeeded as trustee of said trust. [R. 96-97, 124.]

The real property conveyed to the trustee was to be held by the trustee (also called the payee) as security for the payment to it of the sum of $14,000.00 as evidenced by a promissory note dated January 28, 1926, and interest thereon, and for the payment to said payee of such other loans and advances as may be made by the payee during the continuance of the trust to the board of managers. Each trustor agreed that he, his successors and assigns, should be severally liable to the payee for the payment of the balance due on the note or notes in the proportion set opposite his name, as beneficiary. [R. 111-112.]

The trust provided for a board of managers consisting of three beneficiaries of the trust who were vested with the powers and responsibilities provided therefor in the trust instrument. The members of the board of managers

were named in the trust itself. [R. 111.] The board held office at the pleasure of the majority in interest of the beneficiaries of the trust, and such majority filled any vacancy. [R. 111.] The only powers of said board were: (1) To receive loans and advances from the trustee and to execute notes therefor [R. 111-112]; (2) To enter into agreements with the trustee as to the manner of subdividing and improving the real property [R. 112]; (3) To prepare a map of any such subdivision [R. 112]; (4) To enter into agreements with the trustee as to the minimum selling prices of any of said real property [R. 112-113], but this power was not exclusive. [R. 113.]

The trust set forth the powers of the trustee: To hold said property as security for the payment of the said loan or loans [R. 111-112]; to subdivide and sell the said property by lot or lots free of the lien of the payee upon such terms and conditions and for such prices as the trustee deemed best, but for not less than the prices agreed upon by the trustee and the board of managers or the selling agent and for not less than that portion of the amount then due the payee that the area of the parcel sold bears to the unsold parcels of all said property [R. 112-113]; to receive the proceeds of any such sale [R. 113]; to distribute the cash proceeds from the execution of the said note or notes or from the sale of the lot or lots in a certain and definite manner as set out in Paragraph IV of said trust [R. 113-114]; to declare a default for non-payment of the debts secured by the said trust and sell the property at a trustee's sale and distribute the proceeds of such sale. [R. 117-120.] No other powers and no discretions are provided or given the trustee.

There was not a free and easy method of transfer of beneficial interests, as no sale or transfer was valid or

binding on the trustee unless and until an executed original of the assignment evidencing such sale or transfer was filed with the trustee. [R. 115.]

The trust expressly made the beneficiaries liable for their respective proportions of the principal and interest of all loans, liens, and encumbrances against the property of the trust, all taxes, insurance, assessments, liens or charges or expenses necessary or proper for the preservation, maintenance and care of the said property or title thereto, and the costs, charges and expenses of said trust, together with all other sums or amounts properly payable by them in connection with said trust, the property therein described or the beneficial interests thereunder. [R. 112, 116.]

The trust agreement provided for the revocation of the trust by the beneficiaries (who were also the trustors) upon the repayment of all loans and other moneys due the trustee, and in such event the trustee was required to convey and deliver to the then beneficiaries under the trust, as their interests might appear, the title to all the real property then vested in the trustee. [R. 121.]

The beneficiaries of said trust were the beneficial owners of the real property covered by said trust, and their interests were not merely personal claims. [R. 114-115.]

There were no provisions in said trust for the appointment of successor trustees; and no provisions for the taking in of additional capital or members. [R. 109-123.]

The trust had no offices; it had no officers, except as the board of managers might be so construed to be [R. 172]; the trust issued no shares, or certificates, or other evidence of interest therein and had no stock ledger, or stock certificate book, or any books in lieu thereof; it had no

seal, by-laws or minute book; it had no employees other than the board of managers and selling agent; it held no meetings. [R. 173.] The foregoing facts were based on the testimony of the assistant trust officer of the Bank of America National Trust and Savings Association, who also testified that the board of managers never organized [R. 161] and that the trustee sought advice and instructions from the beneficiaries of the trust as to its actions. [R. 163.]

The court further found as to the amount of tax payments made by the trust, fully itemized as to amount, kind of tax and the dates of the respective payments thereof, the filing of the claims for the refund thereof and the rejection of said claims by the Commissioner of Internal Revenue, and notice thereof to the trustee. [R. 97-109.] Copies of the claims for refund, the rejections and notices thereof were attached to the stipulation of facts and found by the court to be true and correct copies and incorporated into the findings of fact. [R. 128-155, 172.]

At the trial of the instant matter, on stipulation, defendant below filed its amended answer, setting up a claim for the tax for the calendar year 1938 against the trust on its undistributed income, in the event the trust was found not to be an association taxable as a corporation. It was further stipulated that the new matter was deemed to be denied by plaintiff below. [R. 157-159.]

Upon the foregoing findings of fact, the District Court concluded in favor of plaintiff below on all issues and further concluded plaintiff was entitled to judgment for the refund of the taxes paid, with interest from the respective dates of payment. [R. 173-174.]

Corrections of Errors in the Transcript of Record and the Brief for the United States.

Although the transcript of record is properly entitled and prepared certain of the pages are entitled "David T. Honeyman, *et al.*, vs." The name "David T. Honeyman, *et al.*," is an error and should be "United States of America." The printed matter appearing on said pages so entitled is a correct portion of the transcript of record in the instant case.

In the Brief for the United States point 6 of "Statement of Points to Be Urged" all after the comma reading ". . . and in entering judgment for defendant and in not entering judgment for plaintiff" is reversed. (Appellant's Br. p. 9.) The words "plaintiff" and "defendant" should be reversed.

Questions Presented.

1. Was the taxpayer an association taxable as a corporation under the provisions of Section 901(a)(2) of the Revenue Act of 1938, c. 289, 52 Stat. 447, for the year 1938, and Section 3797(a)(3) of the Internal Revenue Code for the years 1939 to 1941, inclusive?

2. If the answer to question 1 is in the negative, is taxpayer taxable as a trust on its undistributed income for the year 1938 under Section 162 of the Internal Revenue Code, or is it exempt under Section 166 of the Internal Revenue Code?

Summary of Argument.

The taxpayer is not an association taxable as a corporation because it was created to secure the repayment of a loan and to liquidate property owned by certain individuals.

It was not created to conduct a business enterprise for profit.

The trust here involved does not have the features of a corporation in that: (1) While title is in a trustee, there is no provision in the trust for succession; (2) There is no centralization of management. It is divided by the provisions of the trust agreement between the trustee, the selling agent and the board of managers in like manner as was provided in the trust agreement in the case of *A. A. Lewis & Co. v. Commissioner*, 301 U. S. 385, 57 S. Ct. 799, 81 L. Ed. 1174; (3) There is no provision in the trust agreement providing for security from termination or interruption by the death of any of the beneficiaries, although like almost all ordinary trusts it is secure from such termination; (4) There is no facility of transfer of beneficial interests and no provision for taking in new participants or capital. The transfer of any interest of a beneficiary is restricted and limited by specific provisions of the trust agreement; (5) Personal liability is specifically imposed on the beneficiaries by the provisions of the trust agreement.

The trust is not taxable on its undistributed income under Section 162 of the Internal Revenue Code, since the grantors acting alone have the power to revoke it and hence the income is taxable to the trustors under Section 166 of the Internal Revenue Code.

ARGUMENT.

I.

The Taxpayer Trust Is Not an Association Taxable as a Corporation Within the Meaning of the Applicable Internal Revenue Laws.

The answer to the opposed contentions of the Government and the taxpayer turns upon an analysis of the findings of fact in the light of the law laid down by the Supreme Court of the United States in *Morrissey v. Commissioner,* 296 U. S. 344, 56 S. Ct. 289, 80 L. Ed. 263, and the three companion cases, *Swanson, et al. v. Commissioner,* 296 U. S. 362, 56 S. Ct. 283, 80 L. Ed. 273; *Helvering v. Coleman-Gilbert Associates,* 296 U. S. 369, 56 S. Ct. 285, 80 L. Ed. 278; *Helvering v. Combs,* 296 U. S. 365, 56 S. Ct. 287, 80 L. Ed. 275.

It is now well established that the foregoing decisions laid down two primary tests in the determination of the taxability of a trust as an association (a) The trust must have been created and maintained as a business enterprise for profit or gain; and (b) It must have the salient features of a corporation.

(a) The Trust Was Created for Non-business Purposes.

(1) It was created to secure the repayment of a loan. The purpose for which the instant trust was created is clearly and unequivocally stated in Paragraph II of the trust instrument, as follows:

> "The Trustee, hereinafter sometimes called the payee, shall hold said property as security for the payment to it of the sum of Fourteen Thousand Dollars ($14,000.00) . . ." [R. 111.]

The trust then was formed to provide security for the repayment of a loan—a most common procedure in California, and one which is provided for in the Civil Code of California. Chap. 2, Title 14, Part IV, Division III, Section 2290, *et seq.*

Indeed it is common knowledge, of which we submit this Court may take judicial knowledge, that trust deeds as security for the repayment of a loan are used in California to the almost, if not, complete exclusion of mortgages. Should there be any doubt of this statement a reference to Cal. Jur., Supp., Sections 101, 102 and 103, will disclose that in the nineteen-year period from 1926 to 1945 there were but six cases reported involving foreclosure of a mortgage, and each of them involved a construction of a grant as a mortage. If California was not so predominantly a "Trust Deed" state but was a "Common Law" state, a mortgage would have been given as security for the repayment of the loan and a trust would never have been created. In such event, we submit, the question of the taxability of the trust or mortgage as a corporation would not have arisen.

In *Porter v. Commissioner,* 130 F. (2d) 276, this Court at pages 279-280 quotes most approvingly from *Fidelity-Bankers Trust Co. v. Helvering,* 72 App. D. C. 1, 113 F. (2d) 14, as follows:

> ". . . But not all trusts are taxable as corporations. Under the pertinent statutes only those engaged in doing business for profit or income are so taxed. A trust does not engage in business, for pur-

poses of the tax, if its sole or *principal* object and activities are: (1) preservation of specified property; (2) liquidation of a trust estate; (3) distribution of income derived from another source. . . ." (Emphasis supplied.)

Had this Honorable Court quoted further, the following would have followed immediately:

> "*Clearly the same rule should apply if its function is exclusively to service the security of a loan.* The ultimate question is whether the trust performs *some non-business function of this sort* or operates a business enterprise as a going concern." (Emphasis supplied.)

The foregoing case is the only one dealing with a trust to service a loan which we have been able to find since the Supreme Court rendered its decisions in *Morrissey v. Commissioner, supra,* and companion cases.

However, in *Commissioner v. McCormick,* 68 F. (2d) 653, decided before *Morrissey v. Commissioner,* the Court held the trust there involved was not engaged in business for profit where a trust of real property was formed and beneficial certificates were issued. The beneficiaries were unwilling to mortgage the real property, but hypothecated the certificates as security for a loan.

That the instant trust was primarily formed as security for the repayment of a loan is amply borne out by Paragraph VII of the trust agreement [R. 117-120] which provides for the sale of the property by the trustee in the event of default in the payment of the loan—a provision found in all trusts given as security for the repayment of a loan (25 *Cal. Jur.* 8, 9)—and which is in accord

with the provisions of Section 2924 of the Civil Code of California.

We respectfully submit that the trust was "created and maintained" as security for the repayment of a loan, a purely non-business purpose, and was not "created and maintained as a medium for carrying on a business enterprise" for gain, and therefore is not an association taxable as a corporation.

> *Commissioner v. Gibbs-Preyer Trust 1 and 2,* 117 F. (2d) 619;
>
> *Pieroni Building Trust, etc. v. Commissioner,* 45 B. T. A. 157.

(2) The trust is a liquidating trust.

In addition to being a trust for the security for the repayment of a loan, the instant trust is purely and simply a liquidation trust—another purely non-business purpose and function.

> *Fidelity Bankers Trust Co. v. Helvering, supra;*
>
> *Porter v. Commissioner, supra;*
>
> *United States v. Davidson,* 115 F. (2d) 799, 800.

The adjudicated cases, both before and after the Supreme Court decision in *Morrissey v. Commissioner* are unanimous in holding that a liquidation trust is not an association taxable as a corporation.

In *Morrissey v. Commissioner, supra,* at page 296 (56 S. Ct.), Mr. Chief Justice Hughes points out that the trust there in question: ". . . was not a liquidating trust."

In *United States v. Davidson,* 115 F. (2d) 799 (cited with approval by this Honorable Court in *Porter v. Com-*

missioner, supra), the trust provided that the primary purpose of the trust was to convert the trust property into cash and distribute the net proceeds to the beneficiaries who owned certificates of shares in the trust. The Court held the trust was a liquidation trust and hence not an association taxable as a corporation.

In *Girard Trust Co. v. Commissioner,* 34 B. T. A. 1066, the Board, in holding the trust there involved was a liquidation trust, said at page 1069:

> "Subdivision was the only effective way of disposition, and to have the deed to each lot executed by all interested individuals would have been too cumbersome. The fact that in the process of liquidation they sought the best price—if possible a profit—and were financially able to resist immediate sale at less than a fair value does not stamp the liquidation as a business enterprise."

In *Broadway-Brompton Building Liquidation Trust, etc. v. Commissioner,* 34 B. T. A. 1089, the petitioner trust was formed by bondholders to take over two defaulted mortgages for the purpose of acquiring and selling the assets covered by the mortgages and distributing the net proceeds to the bondholders. The trust issued certificates in direct relation to the bonds contributed. The trust provided for Trust Managers. Powers to operate the properties pending sale thereof was provided, liability was limited to the property embarked on the undertaking; certificate holders were given a beneficial interest in the net income coming into the hands of the Trust Managers and Trustee only.

The Board held the trust was a liquidating trust and held it was not an association taxable as a corporation. The Board in answer to Commissioner's contention that the activities of the trust in renting the properties for profit indicated a business purpose, said at page 1093:

> "The law does not require that in liquidating a property the owner must abandon all ordinary business judgment and sacrifice the property immediately without regard for condition of the market or amount of loss. The liquidation is to be accomplished with reasonable regard for all surrounding circumstances. These circumstances may vary with the type of property and the state of the market."

In *Frederick Pitzman, et al., Trustees v. Commissioner,* 36 B. T. A. 81, the Board in holding the trust there involved was a liquidating trust cites the two foregoing cases and says at page 92:

> "In each proceeding we held that the trust was taxable as a trust, because each trust was created for liquidation purposes and not to enter into a business enterprise."

The language used in the trust in *United States v. Davidson, supra,* at page 800 was held by this Honorable Court in *Porter v. Commissioner, supra,* at page 280 to clearly result in the creation of a liquidation trust.

The language which the Board refers to in the *Pitzman* case, *supra,* as showing the trusts there involved were liquidating trusts is: ". . . to dispose of the realty in such times and such manner as the trustees deem to be to the best interest of the beneficiaries" and ". . . the trustees are given absolute control of the trust estate for the purpose of alienating the same."

In the *Broadway-Brompton* case, *supra,* the Board, in holding the trust was a liquidating trust, refers to the fact:

> "The trust agreement contains no provision for continuing business but the trustee is required to distribute the proceeds of the operation and liquidation of the property."

So, in the instant trust, we find like provisions as follows:

The trustee is

> "To sell said real property by lot or lots free of the lien of the Payee hereunder, upon such terms and conditions, to such purchasers, for such prices and payable in such manner as said trustee may deem best, . . ." [R. 112-113.]
>
> "To receive the proceeds arising from the sale of said property." [R. 113.]
>
> "To distribute the cash proceeds arising from the execution of said note or notes or from the sale of lot or lots hereunder as follows:"

after payment of costs, expenses and fees of trustees and selling agent, amounts required to procure release of liens, bills against said property and amounts to the Payee of the note referred to in Par. II [R. 111-112] the balance to the beneficiaries. [R. 113-114.]

There are no provisions in the trust agreement for continuing business, no power to invest or reinvest the trust corpus or income, but the trustee must distribute the proceeds of the sales, *i. e.,* the liquidation of the trust corpus.

The trust here involved, it is submitted, is a liquidation trust and therefore was not created or maintained for a

business enterprise and hence is not an association taxable as a corporation.

The government maintains that the instant trust was created to engage in a business enterprise. It quotes from *Morrissey v. Commissioner* on pages 13 and 14 of its brief and then *concludes* that the instant trust was clearly purposed for the carrying on of a business enterprise for profit or gain, quoting at the bottom of page 14 from *Morrissey v. Commissioner.* This is exactly the same argument made in the *Frederick Pitzman* case, *supra,* at page 94, but of which the Board said ". . . each of these is grounded upon the facts in the case decided," and held the trusts there, even though dealing in real estate and constructing improvements, were liquidation trusts.

And in the *Broadway-Brompton* case, *supra,* the Government bottomed its contention as here and the Board held, even though the trust was actually renting its property pending sale, that it was a liquidation trust.

A subdivision was involved in the trust which the Supreme Court considered in *A. A. Lewis & Co. v. Commissioner,* 301 U. S. 385, 57 S. Ct. 799, 81 L. Ed. 1174, and wherein there was "dealing in real estate, the development of a tract of land, and construction of improvements . . ." yet the Supreme Court held the trust was not created or maintained to engage in a business enterprise for profit.

Obviously, we think, it is necessary to have more than a trust corpus consisting of real estate to constitute an engagement in a business enterprise.

The Government throughout its brief makes such unsupported conclusions as appear at the top of page 15, "It is clear, moreover, that the primary purpose for

organization of the trust was to improve, subdivide and sell a tract of land at a profit, which was a definite business enterprise." Yet in the very next paragraph in stating the *facts* the Government says the trustee was to "hold the real property as security for that loan. . . ." This last quotation from the Government's brief is a clear statement of *fact* as opposed to the Government's conclusion, of the purpose for the formation of the instant trust.

Following an analysis of the trust provisions the Government turns to cases dealing with the question what constitutes *doing business* by a *corporation* for the purposes of the capital stock tax.

We respectfully submit that such cases as are cited on page 18 of the Government's brief dealing with the above question are not in point: (1) Because the very question which is in issue herein is the postulate upon which the Court's decision is made in such cases. In the capital stock cases there *is* a *corporation* formed for a certain given purpose and the only question is—Is the corporation performing that activity, however, slight, for which it was formed? If so, it is doing business within the meaning of the capital stock tax provisions. So held this Court in *Section Seven Corp. v. Anglim,* 136 F. (2d) 155 at 158.

In the instant matter the primary question is—What is the principal purpose for which the trust was formed—a business or a non-business purpose?

In the capital stock tax cases it matters not why the corporation was formed *so long as it is doing that for which it was organized.*

For example—as shown above and concurred in by the Government on page 21 of its brief—a *trust* formed to

liquidate an estate is not formed for a business purpose and hence is not an association taxable as a corporation. Yet for the purposes of the capital stock tax a *corporation* formed to liquidate an estate and performing that activity is held to be "doing business" and hence subject to the capital stock tax.

> *Magruder v. Washington, B. & A. Realty Corp.*, 316 U. S. 69; 62 S. Ct. 922; 86 L. Ed. 1278.

See, also:

> *United States v. Western Shore Lumber Co.*, 136 F. (2d) 628.

In every case dealing with the capital stock tax cited by the Government in its brief, the *corporation* was doing that for which it was organized and as said by the Supreme Court in *Edwards v. Chile Copper Co.*, 270 U. S. 452, 455; 46 S. Ct. 345, 346; 70 L. Ed. 678, in holding the corporation subject to the tax there involved: "It was organized for profit and was doing what it principally was organized to do in order to realize profit."

To say in the instant case that the trust is an association because it was doing what it was organized to do is to beg the question since the question whether it is an association must turn on a determination of what it was organized to do.

The question of what constitutes "doing business" by a corporation being one of degree depending on the purpose of the inquiry, whether to subject the corporation to process in a foreign jurisdiction, to subject it to tax, or subject it to qualifying in a foreign state, decisions dealing with the question must be limited to the purpose of the inquiry.

See *Prentice-Hall State and Local Tax Service* (Cal.), Vol. 1, paragraph 7202, *et seq.*, for a full discussion thereon.

We would like to pose the question whether, with the many decided cases dealing with the question here involved—when is a trust an association taxable as a corporation—is it not odd that the Government has not cited even one such case dealing with "business purpose" in support of its contention that the instant trust was created as a "business enterprise."

On page 21 of its brief the Government has, we believe, for all practical purposes stipulated to the affirmance by this Court of the judgment rendered below. For there, it cites *Girard Trust Co. v. Commissioner,* 34 B. T. A. 1066; *Broadway-Brompton Building Liquidation Trust v. Commissioner,* 34 B. T. A. 1089; *Pitzman v. Commissioner,* 36 B. T. A. 81 (all three of which have been treated hereinabove) and says of said cases that they ". . . are clear liquidation trust cases with which *we do not disagree since they are correct on their facts. . . .*" (emphasis supplied) and then makes the *unsupported* statement ". . . but in no way analogous to this case." The Government nowhere in its brief attempts to distinguish the said cases, whereas we have demonstrated their similarity to the instant case.

In *Girard Trust Co.* nine persons entered into a trust agreement with Girard Trust Co. as trustee, wherein the trustee received a tract of real property consisting of 54 acres "to manage, develope, improve, grant, bargain, sell and convey the same or any part thereof and to receive, collect and receipt for any and all sums of money whether in cash, or partly in cash and partly in mortgages derived

from such sale or sales thereof; and shall hold any and all such sums . . . (for nine children and transfer it to them in equal parts) . . . less its charges and less any and all proper charges for development and improvement . . ." The trustors reserved an interest only in the proceeds of sale. They bound themselves to pay all taxes, debts, development and other expenses of the tract *pro rata.* They ratified a subdivision contract which the trustee had previously made with a contracting firm. The property was subdivided and sold by lots and one lease was made by the trustee.

The Government made the same contention there as here, citing *Morrissey v. Commissioner, supra,* and its companion cases, and stated "and the fact that from the testimony this trust was created for the purpose of engaging in a business for profit and was engaged in subdividing real estate, the purpose of which was to acquire larger profits."

The Board held the trust was a liquidating trust.

Wherein lies the difference between that case and this, except in the *Girard Trust Co.* case there were nine trustors, here fourteen, there 54 acres, here 40? We submit the language which the Board held sufficient to show a liquidation purpose is no different than the language in the instant trust and the similarity of the cases is obvious. By its agreement with the decision in the *Girard Trust Co.* case, the Government must perforce agree with the District Court's judgment herein.

We have already dealt sufficiently of the *Broadway-Brompton* case to show that the instant case is a *far* stronger case for taxpayer than the cited case for in the cited case the trustee and trust managers issued certifi-

cates, here none are provided for and none issued, there two three-story store and apartment buildings and a 350-car capacity public garage were actually operated pending sale.

And so with the *Pitzman* case.

Since the Government, although making the same arguments there as here, agrees that the Board of Tax Appeal's decisions in those cases are correct, we submit the facts of the instant trust bring this case well within the facts and decisions rendered therein, and here as there this trust is a liquidation trust and hence not an association taxable as a corporation.

Willis v. Commissioner, 58 F. (2d) 121, cited on pages 21 and 11; *Sloan v. Commissioner,* 63 F. (2d) 666, cited on page 11, and *Merchants Trust Co. v. Welch,* 59 F. (2d) 630, page 27 of the Government's brief, were decided long prior to *Morrissey v. Commissioner, supra,* and hence are no longer authoritative.

> *Porter v. Commissioner* (9 Cir.), 130 F. (2d) 276, 280.

We have already shown that *Magruder v. Washington B. & A. Realty Corp.,* 316 U. S. 69, is not only not controlling herein as claimed on page 23 of the Government's brief, but is not even pertinent herein since it is a capital stock tax case dealing with what constitutes "doing business."

Concluding this point, we respectfully submit that appellee was not created or maintained as a business enterprise for profit or gain but was purely a trust deed given as a security for the repayment of a loan and a liquidation trust, and hence is not an association taxable as a corporation.

(b) The Trust Has None of the Salient Features of a Corporation.

The Supreme Court in the *Morrissey* case, *supra,* lays down five salient features which make a trust analogous to a corporation. They are:

(1) Title to the property held by trustees as a continuing body with provision for succession.

Title is held by the trustee as in all trusts, but there is no provision in the trust agreement for succession. Appellant admits this, but claims it is of no consequence because the "corporate nature of the trustee has the element of continuity inherent in itself." But there is a difference between "a continuing body" and "provision for succession." Else why did the Supreme Court use both terms? The Court meant by "provision for succession" a provision in the trust agreement for the Court says "whether the trustees are named in the trust instrument with power to select their successors . . . or are selected by or with the advice of those beneficially interested. . . ."

In the *Morrissey* case and in *Helvering v. Coleman-Gilbert Associates, supra,* the trust instrument provided for the trustees to select their successors.

(2) Centralization of management in trustees who act "in much the same manner as directors."

There is no centralization of management herein. It is divided by the provisions of the trust between the trustees and the selling agent and the board of managers in like manner as was provided in the trust agreement in the case of *A. A. Lewis & Co. v. Commissioner,* 301 U. S. 385, 57 S. Ct. 799, 81 L. Ed. 1174, and the trustors, who re-

served the right to rent the property, to procure insurance, pay principal and interest of any debt, taxes or assessments levied or assessed against the trust property. [R. 116.]

The very things referred to on page 24 of appellant's brief were held by the Supreme Court in the *A. A. Lewis Co.* case, *supra,* to be "purely ministerial." The same powers as are provided in the instant trust were present in the *A. A. Lewis Co.* trust as will be shown later herein, and the Court said these powers gave "no essential characteristic of corporate control. . . ."

Appellant completely ignores the selling agent and his powers and those which were reserved by trustors.

(3) Security from termination or interruption by the death of owners of the beneficial interests.

The instant trust, like almost all ordinary trusts and many limited partnerships, is secure from such termination—although there is no provision in the trust instrument to that effect.

In the *Morrissey* case, the trust itself provided that the death of a trustee or beneficiary was not to terminate the trust.

(4) Facility of transfer of beneficial interests and introduction of large numbers of participants.

Not only is there no facility of transfer of beneficial interests, but the transfer is specifically limited and restricted by the provisions of Paragraph VI of the trust. [R. 115.]

With like provisions in the trust regarding assignment of beneficial interests, this Court in *Commissioner v. Gerstle,* 95 F. (2d) 587, said at page 589:

> "Two of the characteristic advantages of corporate organization have been generally thought to be the limited liability of the members, and a ready divisibility and transferability of beneficial interests, making toward the inclusion in the enterprise of large numbers of participants. . . . Their beneficial interests were not readily or conveniently transferable."

The exact condition is true of the transferability of the interests in the instant trust.

In the *Morrissey* case there were certificates issued which were readily transferred the same as stock of a corporation.

(5) Limitation of personal liability of the participants *to the property embarked in the undertaking.*

In the *Morrissey* and companion cases the trusts provided that the trustees were "without power to bind the beneficiaries personally by 'any act, neglect or default' and the beneficiaries and all persons dealing with the trustees were required to look for payment or indemnity to the trust property."

It is noted that the Supreme Court in the *Morrissey* case says limitation of personal liability "to the property embarked in the undertaking."

Every case which we have found, save one, refers to this same type of limitation of personal liability. For example, this Court in *Commissioner v. Gerstle, supra,* at 589, with reference to the *pro rata* liability of the mem-

bers for all expenses, loans and losses of the syndicate, said: "The liability of the syndicate members was not limited."

The exception to this general holding by the Courts above referred to is this Court's decision in *Commissioner v. Security-First National Bank,* 148 F. (2d) 937, wherein this Court held such *pro rata* liability is the equivalent of limited liability and appears to give as its reason therefor that California Civil Code Section 331 comprehends such assessment of corporate shareholders.

This Court's decision in the latter case appears to be in conflict with its decision in the *Gerstle* case.

We respectfully submit that this Court's decision in the *Gerstle* case is in harmony with the Supreme Court's decision in the *Morrissey* case, while the decision in the *Security-First National Bank* case appears to be in conflict with the *Morrissey* case wherein the limitation of personal liability had reference to the liability being limited to the property originally embarked in the undertaking and also appears to be in conflict with *Burk-Waggoner Oil Association v. Hopkins,* 269 U. S. 110, 46 S. Ct. 48, 70 L. Ed. 183, in applying local law, to-wit, California Civil Code, Section 331. In the *Burk-Waggoner* case the Court held that local law would not be recognized in determining the taxability of the taxpayer as an association.

The *Burk-Waggoner* case has been held to be authority that local law is not controlling in the matter of Federal taxation.

> *Walter A. Frederick,* 2 T. C. 936, 945;
>
> *Coast Carton Co.,* 149 F. (2d) 739, 742 (9th Cir).

The reason is clear. Suppose the Delaware law does not permit such stockholders' assessment as does California Civil Code Section 331, then a trust in Delaware with provision for *pro rata* liability of the members would not possess this feature of a corporation, but a California trust with like provisions would, and this conceivably could mean the difference between a trust being an association in California while not being such in Delaware.

We respectfully submit that this Honorable Court should adhere to its decision in the *Gerstle* case and refute its holding in the *Security-First National Bank* case.

Frederick Pitzman, 36 B. T. A. 81, 92.

In *A. A. Lewis & Co. v. Commissioner, supra,* the Supreme Court, in speaking of its decision in the *Morrissey* case with respect to the salient features, said:

> "We pointed out that the corporate analogy was evidenced by centralized control, continuity and limited liability, as well as by the issue of transferable certificates."

And the Board of Tax Appeals in *Pitzman v. Commissioner, supra,* at page 92, in speaking of the salient features found present in the trusts there involved, said: ". . . yet these salient features have been found in ordinary trusts without making them associations taxable as corporations."

The next case dealing with the instant question to reach the Supreme Court of United States following the *Morrissey* and companion cases, *supra,* was *A. A. Lewis & Co. v. Commissioner,* 301 U. S. 385; 57 S. Ct. 799; 81 L. Ed. 1174. The *Lewis* case is peculiarly analogous to the instant case and is, we submit, controlling herein.

Appellant seeks to distinguish the *Lewis* case by the fact that there was but one grantor and only two beneficiaries. This difference is without merit for in *Swanson v. Commissioner, supra,* a companion case to the *Morrissey* case, there were but two beneficiaries involved and the Court said the limited number of persons involved does not alter the situation. And this Court in *Lombard Trustees, Limited, et al. v. Commissioner,* 136 F. (2d) 22, wherein there was only *one* beneficiary, said at page 23:

> "There is no merit in this contention. We regard the plural word 'beneficiaries' as inclusive of the singular."

In *Lombard Trustees, supra,* the taxpayer was contending exactly what the Government is contending with respect to the *Lewis* case, namely, that with only one beneficiary there can be no association.

See, also, *Harry Chandler, Prentice-Hall T. C. Memo Cases,* Paragraph 46,164, to the same effect.

This argument loses entire face when it is remembered that the trust in the *Lewis* case provided for the issue of transferable certificates, thus permitting of the introduction of a large number of participants, if the parties so desired.

Except for that one contention, there is no factual difference between the *Lewis* case and the instant case, save that the Lewis trust was formed for the express purpose of subdividing the trust corpus, while the instant trust was formed for the express purpose of securing the repayment of a loan.

The facts in the *Lewis* case, *supra,* are:

A tract of real property was conveyed to a trustee for the purpose of subdividing and selling it. The original trustee was succeeded by the Central Republic Trust Company as successor to said original trustee. The grantor and A. A. Lewis were named the beneficiaries, both of whom signed the instrument as beneficiaries. A. A. Lewis was appointed the manager and selling agent of the trust. He was given "such powers and duties in connection with the administration of the trust as may be necessary to facilitate the sale of said land." The trustee was to execute deeds and other necessary instruments on Lewis' request. The trustee was to collect and distribute the proceeds of sale. Lewis was to receive as compensation a commission based on the prices for which lots in the subdivision were sold. The grantor subsequently assigned her beneficial interest in the trust. The trust instrument provided for the issuance of transferable certificates by the trustee but none were ever issued.

Let us compare the trust here involved with the trust involved in the *Lewis* case, *supra.*

(A) Each trust had a corporate trustee, which was succeeded by a successor corporate trustee. Each trust empowered the trustee to (1) hold title to real property [R. 111]; (2) execute deeds and other necessary instruments on request of the selling agent [R. 120-121], and collect and distribute the proceeds of such sales [R. 113-114], (3) to subdivide the property as agreed on between the trustee and managers or selling agent. [R. 112-113.]

(B) Each trust had managers and a selling agent, who were named in the trust agreement and whose powers were definitely fixed in advance of their exercise—but the

powers of the manager and selling agent in the *Lewis* case were far broader than in the instant trust—for in the *Lewis* case his powers were to do whatever was necessary to facilitate the sale of said land. The only compensation provided in each trust for the managers or selling agents is a commission for the selling agent on the sale of the property, or parts of it.

(C) Each of said trusts provided for the subdivision and sale of specific property transferred to the trustee.

(D) In each, beneficial interests were assigned.

There are, however, two main differences in the two trusts—first, the Lewis trust was created solely and specifically to subdivide and sell real estate; the instant trust was created to secure the repayment of a loan; and second, the Lewis trust provided for the issuance of transferable certificates (though none were issued), a method by which new capital and participants could have been taken in, while in the instant case no provision was made for issuance of transferable, or any other type of certificates.

Thus the facts of the instant case would appear to be stronger in favor of the taxpayer and in resolving the issue in its favor—the trust is *not* an association taxable as a corporation.

As the Court pointed out in the *Lewis* case:

> "The arrangement here answers the . . . description of an ordinary trust—that is, it was created in virtue of a declaration by which a designated piece of real property was conveyed to the trustee on specified trusts, for the benefit of definitely named persons . . . for the sole purpose of subdividing and selling the land. The agent was designated by

name and his powers definitely fixed in advance of their exercise. He possessed no authority beyond that expressly delegated by his principal. The trust was adopted merely as a convenient means of making effective the sales of the agent under the contract. The duties of the trustee were purely ministerial. . . ."

Lewis v. Commissioner, 57 S. Ct. 801.

The Supreme Court held on the foregoing facts that the trust in the *Lewis* case was *not* an association taxable as a corporation and said:

"If it were not for the declaration of trust, we should have here the simple case of an appointment by a land owner of an agent to subdivide the land and sell it, receiving as compensation for his services a fixed percentage of the payments made by the purchasers. It is quite evident that such an arrangement has no element of substance or method which would warrant its designation as an association under the statutory provision in question. Nor can we see that the intervention of a *trustee to hold title, execute contracts and conveyances* at the direction of the real estate agent *and make collections* alters the situation." (Emphasis supplied.)

Lewis v. Commissioner, 57 S. Ct. 800.

The Court, after citing the *Morrissey* case, *supra,* stated:

"The trust reviewed in the *Morrissey* case was essentially unlike that now under consideration."

57 S. Ct. at 800-801.

And again, in summing up its holding, the Court said:

> "There is to be found in the operation of the business no *essential characteristic of corporate control* —nothing analogous to a board of directors or shareholders, *no exemption from personal liability, no issue of transferable certificates of interest.* There is simply the common relation of principal and agent, coupled with the collateral incidents of an ordinary trust." (Emphasis supplied.)
>
> 57 S. Ct. 801.

The similarity of the instant case and the *Lewis* case having been demonstrated by a comparison of the trust instruments, we submit, the Supreme Court's statements and holding are equally applicable in the instant matter except as to the purpose which, as stated, in the instant case was primarily to secure a loan and only incidentally to subdivide the land, while in the *Lewis* case was solely to subdivide and sell the land.

In the instant case, as in the *Lewis* case, as said by the Supreme Court, there is nothing analogous to a board of directors or shareholders, no exemption from personal liability, no issue of transferable certificates of interest. *Not one power is given in the instant trust that was not given in the Lewis trust, except as to the loan.*

It is noteworthy, we believe, that the Government in its brief does not distinguish the trust in the *Lewis* case from the instant trust, but distinguishes it from the trust in the *Morrissey* case. We readily agree that the *Lewis* trust is entirely distinguishable from the *Morrissey* trust. Our comparison of the *Lewis* trust and the instant trust, *supra,* shows conclusively, we submit, that the instant

trust is equally distinguishable from the *Morrissey* trust and very analogous and similar to the *Lewis* trust.

In *Commissioner v. Gerstle,* 95 F. (2d) 587, this Honorable Court held the syndicate trusts there involved were not associations taxable as corporations.

The facts in the *Gerstle* case, *supra,* were:

The members of the syndicate were directors of corporations owning large department stores in San Francisco and Oakland. In 1927 it was decided to build a new store in Oakland some distance from the then business district. The members of the syndicate decided to purchase some property in the vicinity of the proposed store in order to realize profits from the expected rise in land values. The original plan was expanded to purchase other properties in Oakland in anticipation of a general rise in real estate values. Accordingly, four syndicates were formed, the members contributing to a pool to finance the purchases. The agreements recited that the members were desirous of acting jointly in the purchase, management and sale of real properties in Oakland and appointed syndicate managers to act as agents and trustees. It was agreed that the managers should have complete discretion in the purchase of the properties, the selection thereof and the price to be paid, the details of management and the terms of sale, etc. and all other matters relating to the syndicate. They were liable *pro rata* for all expenses, loans and losses of the syndicate. Syndicate managers were chosen by the members. Assignments of interests in the syndicate were restricted. No certificates or other evidence of beneficial interest were provided for or issued. The anticipated rise in prices did not occur and the syndicate managers oper-

ated certain of the buildings and rented the remaining unimproved properties.

The syndicates, as such, had no name. There were no officers, except as the managers might be so considered. The agreement provided the sole evidence of the several members. The practice was to decide all questions of importance only after the views of the members were obtained. The managers did not organize. The bank, as fiscal agent, kept all records. The funds advanced by the bank both for the acquisition and subsequent maintenance of the properties were secured by declarations of trust covering the syndicate assets.

This Court, after citing and quoting from *Morrissey v. Commissioner, supra,* and referring to the five salient features set forth therein (including the reference to limitation of personal liability to the *property embarked in the undertaking*) said at page 589:

> "Certain of these features were present in the syndicates involved . . . continuity of the enterprise was effected, insuring against disturbance resulting from death or transfer of ownership of beneficial interests. Centralized management was provided for in the agreements. . . . In other respects, these syndicates lack analogy to corporations. Two of the characteristic advantages of corporate organization have been generally thought to be the limited liability of the members, and a ready divisibility and transferability of beneficial interests, making toward the inclusion in the enterprise of large numbers of participants. The liability of the syndicate members was not limited. Their beneficial interests were not readily or conveniently transferable."

and later, at page 590, the Court said:

> "It seems clear that the members were equitable owners of the real property acquired, and that their beneficial interests were not merely personal claims against the syndicate managers."

Exactly the same words can be applied to the instant trust, save for the centralized management. The instant trust had no name. There were no officers, except as the board of managers might be so considered. The agreement provided the sole evidence of the interest of the several beneficiaries. The trustee (managers) conferred with the beneficiaries on all important questions. The managers did not organize.

The instant trust had continuity, though not by its provisions as above pointed out, but as in the *Gerstle* case it did not provide limited liability of the beneficiaries and it did not provide for ready or convenient divisibility or transferability of beneficial interests, and the beneficiaries were the equitable owners of the corpus of the trust.

See, also, *Commissioner v. Buckley,* 128 F. (2d) 124, wherein the Circuit Court of Appeals for the 9th Circuit held that an investment trust providing transferable registered trust certificates, continuity of existence, centralized management, and limited liability was not an association taxable as a corporation, citing and agreeing with *Commissioner v. Chase National Bank* (2 Cir.), 122 F. (2d) 540, wherein the Court said at page 543, the trust property was to be held for investment and not to be used as capital to transact a business for profit like a corporation organized for such purposes.

The Government in its brief on pages 27 and 28 cites several cases which it contends fully support its contentions. A brief reference to each of the cases will, we submit, show that they are not one whit in point.

As above pointed out *Merchants Trust Co. v. Welch*, 59 F. (2d) 630; *Willis v. Commissioner*, 58 F. (2d) 121; and *Sloan v. Commissioner*, 63 F. (2d) 666, were all decided long prior to *Morrissey v. Commissioner, supra*, and hence under the authority of *Porter v. Commissioner*, 130 F. (2d) 276, are no longer authoritative.

In *Porter v. Commissioner, supra*, cited at the bottom of page 27 of the Government's brief, the trust was created "to engage in any lawful business," to own, buy, sell, improve, etc. real and personal property, to own stock, engage in any industry or investment, "hoping thereby to make gain to the estate. . . ." Shares of stock in a corporation were transferred to the trust by the stockholders of the James Porter Investment Co. The trustees caused the corporation to be dissolved and took over the assets thereof and operated in like manner as the corporation had operated. The trust provided that the trustees were authorized to add to their number and to choose their successors; the trustees were made absolute owners of the trust with full power of management and in their discretion to reinvest or distribute all trust income and funds collected by them. Beneficial interests called "expectancy fractions" were registered in the records of the board of trustees. The trust provided that the death of a beneficiary should not terminate the trust, but his heirs could succeed to his beneficial interest. Annual meetings of the beneficiaries were provided for. The trust was irrevocable and was to continue for any lawful term within the discretion of the trustees.

Looking to the trust instrument to determine its purpose this Court said that the "trust instrument exhibits authority in the trustees to engage in business" and that there "is here no expressed purpose of liquidation, or of conservation, but an avowed intent 'to engage in any lawful business' in order to realize a gain or profit to the trust estate."

Clearly the *Porter* case is no authority in the instant matter.

Next is *Fidelity-Bankers Trust Co. v. Helvering,* 113 F. (2d) 14, wherein stockholders of a financially embarrassed trust company executed a trust to be known as Fidelity Realty Company "for the purpose of acquiring, encumbering, leasing and selling certain real estate and/or other properties. . . ." The syndicate members subscribed for certain amounts set opposite their names for which they received participating certificates which were transferable by endorsement and delivery. A record of the ownership of the certificates was to be kept. The members elected an executive committee. Liability of the members was limited to the property originally embarked in the undertaking. There was to be no termination on death of a member or transfer of a certificate.

The trustee contended that the trust was merely a security for loans to the trust company.

The Court held that *if* it was such a loan and security trust it would not be an association. But the Court held there was no element of loan or security in the trust. It was purposed to and did purchase and operate the properties rather than receive them under a mortgage or deed of trust.

Again we have a clearly business purposed trust with *every* feature of a corporation provided for. We submit the cited case is as different from the instant case as the *Porter* case, *supra.*

Appellant's next cited case is *Title Insurance and Trust Co. v. Commissioner,* 100 F. (2d) 482.

The trust in that case provided for beneficial certificates transferable by endorsement; provided for a register of certificate holders; provided that no assessment shall be made upon any certificate holder; the trustees were empowered to take such steps as in its opinion may be necessary for the best interest of the certificate holders with respect to leasing, operating, selling, conveying or otherwise disposing of the trust property; trustees, except as otherwise provided, shall have exclusive management and control of the trust estate; provided that neither the trustee nor any certificate holder should be personally liable upon any contract or obligation made by the trustee; provided for appointment of a successor trustee.

The Court held it to be an association, saying at page 485:

> "As disclosed by the trust agreement, its purpose was to carry on the business of owning, managing, leasing and selling real property and sharing the gains therefrom."

The Court found that the *trust agreement provided* for each of the five salient features referred to in the *Morrissey* case.

Here again we have a trust which provides for a successor trustee, provides for full management and control in the trustee, provides the trust shall not terminate on

death of a certificate holder or transfer of a certificate; provides for transferable certificates by endorsement and provides for limiting the liability of the certificate holders to the property embarked in the undertaking. As pointed out above the instant trust provides for *none* of those five features.

Again, we submit the *Title Insurance and Trust Co.* case is no authority on the facts and trust in the instant case.

The next case in the Government's brief is *Commissioner v. Vandegrift R. & Inv. Co.,* 82 F. (2d) 387 (C. C. A. 9th), wherein the trust specifically provided for: Beneficial certificates which were issued and were fully transferable; the beneficiaries retained no interest in the trust property and could only enforce the trust provisions; the trustees to engage in business and empowered them to purchase, sell, lease, manage, improve and develope real estate, to engage in a general contracting and construction business, and were given all the powers incidental to carrying on a business; no assessments being levied against or upon certificate holders; self-perpetuation of trustees with power to fill vacancies and were not subject to control of the beneficiaries; the trust had in earlier years operated a shoe business but had disposed of it prior to the year under consideration. The Board of Tax Appeals had held the trust taxable as a corporation while operating the shoe business but not so taxable after the liquidation of the shoe business.

The Court held that as the trust was organized to carry on a business and as the Board had held it taxable as a corporation in the earlier years, and it was carrying on the same activities, except for the operation of the shoe

industry, it was still so taxable. Among its activities in the years involved were leasing property, acquiring and managing property and accumulating a reserve to build a building if a fire should destroy a rented building.

The Court looked to the trust to determine its purpose and not to what it was doing—but what it could have done.

Certainly the trust in that case, as in the preceding cases, is far afield from the instant case, and is not even persuasive, let alone controlling, in the instant case.

In *Del Mar Addition v. Commissioner,* 113 F. (2d) 410, the trust specifically provided for the trustees to choose their own successors, vested all control and management of the property in the trustees, and that the trust should have continued existence and operation despite the death of a beneficiary. Interests in the trust were transferable.

The trust was created to acquire, develop and sell real estate.

The Court affirmed the Board of Tax Appeals holding that it was taxable as a corporation because of its "striking similarity" to the trust in the *Morrissey* case.

We have already seen how unlike the instant trust is from the *Morrissey* trust, and, hence, how unlike it is from the *Del Mar Addition* trust.

The next case cited by the Government is *Wellston Hills Syndicate Fund v. Commissioner,* 101 F. (2d) 924, of which the Government on page 13 of its brief filed in the District Court said: "A more parallel situation to the case at bar could hardly be found."

The facts of the *Wellston* case are:

One C. C. Willmore was engaged in the business of real estate and land development. He owned all the stock of the Cyrus Crane Willmore Organization, Incorporated. The company was organized to conduct a general real estate business, including acquirement, holding, improvement and disposition of real estate, and to execute, acquire, hold and dispose of notes, mortgages and bonds. This company was the agency through which Willmore operated.

In order to acquire, improve and dispose of certain real estate he caused a new corporation, Wellston Hills Realty Company, to be formed, the old company owning all the stock of the new. The Realty Company acquired the land. Two days later the Wellston Hills Syndicate Fund was established by an agreement between the Realty Company and "the subscribers hereto collectively."

The agreement provided that the company had purchased the land and needed financial aid to pay for it and to improve and develop it and properly market it, and the Syndicate Subscribers have agreed to furnish the financial aid. The company was to be the "Syndicate Manager." The Syndicate was to furnish $95,000 and the company $5,000, which $100,000 was to be used to pay for said land, to pay interest on money borrowed, to pay engineers' fees and for the improvement and development of the land. The Syndicate Subscribers were not to be regarded as partners of each other or of the company. The funds advanced by the Syndicate were not to be regarded as a loan but were to finance the project.

Amounts received from the sales were to be deposited to the credit of the Syndicate and paid out (1) 25% to the company, (2) 6% per annum to Subscribers, (3) to fully pay for the land and improvements, etc., (4) such amounts to the Syndicate Subscribers as the company determines are available for distribution, and (5) after payment of all debts, etc., and upon dissolution, to the Syndicate Subscribers.

The Syndicate Subscribers could be held liable for loss only up to their subscription payments and recourse could not be had against them for losses in excess of the original subscriptions. The separate interests of subscribers were transferable by endorsement and certificates were issued.

The Court held the purpose, as set forth in the agreement, was to make money through the acquisition, improvement and sale of real property.

The Court then looked into whether the agreement revealed sufficient similarity to a corporation. It held "There was centralization of control, in that the Realty Company—the 'Syndicate Manager'—had sole control of the Fund under the provisions and limitations set forth in the contract. There was a continuity of interests and an express disavowal of a partnership relation. There was an express limitation of liability to the amount of the respective subscriptions. There was express power of transferability of individual interests."

In the *Wellston* case we find an individual who was engaged in the real estate business who, in order to *finance a portion of his business,* elicited such financing by a plan whereby he formed a corporation. Not wanting to sell stock in his corporation, he sold subscriptions in his plan called a Syndicate. Unlike the case at bar, where the individuals wishing to dispose of land already owned, the Wellston plan was conceived to acquire the land, to take over a portion of Willmore's business. He gave the subscribers, as shown by the agreement and pointed out by the Court, all the safeguards and management of his corporation,—limited liability, transferable certificates and his corporate management and control.

We submit that the *Wellston* case, albeit defendant's most parallel case in the Court below, is not one whit analogous to the instant case—*but is a tacit admission by the Government that plaintiff is not* an association taxable as a corporation.

The last remaining case cited by and relied on by the Government is *Security-First National Bank v. Commissioner,* 148 F. (2d) 937, of which the Government contended below and states on page 27 of its brief in this Court "is indistinguishable in principle and it is determinative of the issues here."

In this case sixty-two persons created a trust to acquire certain prospective oil land and authorized the trustee to lease it for oil or for other than oil or minerals, to sell or convey it. The trustee was authorized to accept the

royalty from oil and gas lease "in cash or kind." The trust provided for a committee of five beneficiaries to direct the trustee with respect to such leases. Transferable certificates were provided for and issued and certificates were transferred.

The Court, in applying the "business purpose" test to this trust, said:

> "The character of the organization as to whether or not it is a 'business trust' is determined by what the instruments creating the trust empowered the trustee to perform, . . ."

and then says:

> "Here the trustee was empowered to receive the royalties from the oil and gas leases in kind. This would require it to conduct the business of selling the oil or gas to obtain the cash to be distributed to the beneficiaries. The trustee was also empowered to engage in the business of 'rent (ing and) leas (ing the trust property) for other than oil or gas purposes' and sell or convey it outright. The organization was thus purposed to engage in business. . . ."

This Court then held the trust had each of the five salient features of a corporation referred to in the *Morrissey* case, *supra*. We have, above, treated of this Court's holding with respect to the feature of limited liability.

In the *Security-First National Bank* case the Court refers to the trust's power to engage in the oil business and

in the business of renting and leasing the property for other than oil. The rental of the property in the instant trust by the trustee is expressly prohibited. [R. 116.]

How different again from the instant case. There, again, is a case where a trust was formed to acquire property and could enter into the oil business or the rental business, or both, while in the instant case the trust was formed to liquidate the property of the trustors exactly as was the trust in the *A. A. Lewis* case, *supra.*

It is noteworthy that in *each* of the cases involving the question whether a trust is an association, relied on by the Government, the trust was formed to go into the market and *acquire* the property which was the subject of the trust—and hence such trust could not have been a liquidating trust—for one can only liquidate what one has. The Government appears to recognize this and admit it for it uses a capital stock tax *corporation* case, on page 19 of its brief in an attempt to overcome this *vital* difference between the instant case and those relied on by it in its brief. We have, we believe, effectively demonstrated the inapplicability of capital stock tax *corporation* cases wherein the postulate there is the question here.

We submit the instant trust, being purely a loan security and liquidation trust having no business purpose, is controlled by the U. S. Supreme Court's Decision in *A. A. Lewis & Co. v. Commissioner, supra,* and this Court's decision in *Commissioner v. Gerstle, supra,* and is not an association taxable as a corporation.

II.

The Trust Is Not Taxable as a Trust on Its Undistributed Income for the Year 1938.

The Government contends that if the instant trust is not an association, taxable as a corporation, then it was taxable under Section 162, Internal Revenue Code, as a true trust on its undistributed income for the year 1938.

Taxpayer contends that the trust is revocable by the grantors and hence the income is taxable to them under Section 166, Internal Revenue Code.

Sections 162 and 166, Internal Revenue Code, read as follows:

> "Sec. 162. Net Income.
>
> The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that— . . ."
>
> "Sec. 166. Revocable Trusts.
>
> Where *at any time* the power to revest in the grantor title to any part of the corpus of the trust is vested—
>
> (1) in the *grantor, either alone* or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or
>
> (2) . . . (not applicable)
>
> then the *income* of such part of the trust *shall be included in computing the net income of the grantor.*" (Emphasis supplied.)

The grantors and the beneficiaries are the same. [R. 109-110; 114-115.] Paragraph X [R. 121] of the trust gives the beneficairies the *power* to revoke the trust. Hence the grantors reserved the power to revoke the trust.

The power to revoke the trust is vested in the grantors alone. They do not have to act in conjunction with any one whether having an adverse interest or not.

Section 166, I. R. C., is in the *disjunctive*—if the power to revoke the trust is vested in the grantor alone, then the income is taxable to him or if the power to revoke the trust is vested in the grantor and some one else not having such adverse interest, then the income is taxable to the grantor.

The only portion of Section 166(1) which concerns this case is "in the grantor, alone," since the Government concedes on page 35 of its brief that the singular "grantor" includes the plural "grantors".

Section 1 of the Revised Statutes provides that the singular shall include the plural. Said section is incorporated in the Internal Revenue Code by Section 3797.

In *Bromley, Jr. v. Commissioner,* 66 F. (2d) 552, and *Crossett v. United States,* 30 Fed. Supp. 802, it was held that Section 166 applied where there was more than one grantor.

The Government's contention as to the adverse interest of the grantors (Br. 34) or of the beneficiaries (Br. 35) can only mean that the Government is claiming that in

their respective capacities as grantors and beneficiaries they are different persons. *The nicety of that argument as an avenue to tax avoidance* must be clear even to the Government. For example, two individuals in the upper income tax brackets own an encumbered, income producing property as tenants in common, the income from which is includible in their individual income tax returns. They, as grantors, create a trust with such property as the trust corpus and themselves as joint beneficiaries. It is provided that the income may be accumulated. They provide in the trust that they can revoke the trust acting jointly, but only after said encumbrance is paid off or adequately provided for. Under the Government's contention their interests would be adverse since each is "bound to assume his . . . share of the" encumbrance and hence the trust would not be revocable under Section 166 and the income could be accumulated and taxed in lower brackets to the trust.

It is submitted that Congress never intended in its enactment of Section 166 to leave such an obvious loophole for the avoidance of taxes.

The grantors, acting alone, having the power to revoke the trust, the income is taxable to them under Section 166 and not to the trust under Section 162, I. R. C.

Conclusion.

The District Court did not err in concluding that the taxpayer trust is not an association taxable as a corporation within the meaning of Section 901(a)(2) of the Revenue Act of 1938 and Section 3797(a)(3) of the Internal Revenue Code, nor in concluding that the trust was not taxable on its undistributed income for 1938 as an ordinary trust.

The judgment entered by the District Court is correct and should be affirmed.

Dated September 6, 1946.

Respectfully submitted,

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